



State of Washington
Department of Revenue

Excise Tax Advisory

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NUMBER: 086.04.201/203

CONVERSION DATE: July 1, 1998

INCOME FROM A SEPARATE CORPORATION ORGANIZED TO CONDUCT PART OF A PARENT CORPORATIONS BUSINESS

Issued July 22, 1966

Is the Excise Tax applicable to "management fee income" where one corporation organized a separate corporation to conduct a part of its business?

The taxpayer, a Washington corporation, was assessed a Business Tax under the Service and Other Activities classification upon amounts charged by it to the affiliated corporations in Canada and in Washington. These charges were credited to an account on the taxpayer's books entitled "Management Fee Income" but the taxpayer contended that this title was a misnomer and that for accounting purposes the management fees were not treated as an income account but as a deduction of expenses. The auditor treated the transactions as services rendered by the taxpayer to separate entities or persons. The taxpayer answered by claiming that these separate entities were wholly owned corporations which were operated simply as branches of the taxpayer. The products, officers and functionaries were identical for all branches, and all personnel were stationed at the taxpayer's main office in this state. The only employees in Canada were those necessary to operate two warehouses maintained by the Canadian branch. The reason given for organizing a separate corporation in Canada was that it was necessary to ease relations with Canadian and Provincial governmental agencies. If it were not for this consideration, the taxpayer contended the Canadian portion of the business would be operated simply as a branch of the main office in Washington. The credits attributable to the "management fee income" were; officer's salaries, general sales manager's salary, office salaries for those working exclusively on the affiliates' books, and the general overhead.

The Tax Commission held that with respect to the tax assessed it was clear that the officers and employees of the taxpayer performed substantial and valuable services for the Canadian affiliate and that under the law each separately organized corporation is a separate "person" for Excise Tax purposes. (Rule

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203) A deduction for interdepartmental charges is allowed by Rule 201 but "this does not permit the exclusion or deduction of charges against or income derived from an affiliated corporation or other affiliated association."

Rule 203 states that each separately organized corporation shall file a separate return and Include the tax liability accruing to it. and this Rule further applies to each corporation in an affiliated group. No provision is made in the law for a consolidation of returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax.

Therefore, the Commission ruled that if the Canadian portion of the taxpayer's business had actually been set up as simply a branch, no tax would apply with respect to transactions between the two firms or amounts received for services rendered by one to the other. However, in organizing a separate corporation for a part of the business, transactions, as here involved, become subject to the Excise Tax.